

FOUNDATION PAYOUT INCREASE POLICY

by
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Abstract

The endowment payout rate of private foundations for charitable purposes has been 5% since last established in the Economic Recovery Tax Act of 1981. Despite other tax policies having been reassessed in that time, this portion of the tax code has been untouched for almost 30 years, during which the needs of the nonprofit sector have changed drastically. A small number of private foundations have increased their payout rate to give more immediate funding to the organizations that they support, but the vast majority give at or near the minimum 5% required. This policy recommends increasing the private foundation payout rate from 5% to 8% to account for higher indirect costs at nonprofits and the immediacy of many societal issues. While this policy is modest in scope, for the nonprofit field, having a 3% increase in available annual charitable giving could have significant and lasting positive impact on the field.

Advised by: Professor Paul Weinstein

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To: Tamera Ripperda, Commissioner, Tax Exempt and Government Entities Division at the Internal Revenue Service

From: Maria-Veronica Banks, Johns Hopkins University

Subject: Reevaluating Foundation Payouts

Date: February 18, 2020

Action Forcing Event

The MacArthur Foundation, one of the largest private foundations in the country, announced in December 2019 that they will support an indirect cost rate of 29% starting in 2020.¹ They are hoping to lead the field in analyzing the true cost of project grants to destigmatize nonprofits with indirect costs higher than the expected 10-15%.

Statement of the Problem

This memo will look to address the problem of private foundations not giving sufficient funding to public charities to cover their unrestricted costs. Unrestricted costs are defined as general expenses that are not attributed to a program, such as accounting and human resources.² In 2009, The Bridgespan Group published their now-famous essay called “The Nonprofit Starvation Cycle” where they outlined the cycle of donors requiring low overhead rates of 10-15%, public charities skewing their budgets to meet those rates, and donors believing they were sustainable and reasonable rates to request in the first place.³ It

¹ Palfrey, John. “Changing How We Support Indirect Costs.” *MacArthur Foundation*, 16 Dec. 2019, www.macfound.org/press/perspectives/changing-how-we-support-indirect-costs/.

² Paynter, Ben. “5 Ways Nonprofits Struggle (And How To Overcome Them).” Fast Company. Fast Company, April 5, 2018. https://www.fastcompany.com/40552662/5-ways-the-nonprofit-industry-is-failing-and-how-overcome-them?utm_source=postup&utm_medium=email&utm_campaign=Ideas&position=8&partner=newsletter&campaign_date=04052018.

³ Gregory, Ann Goggins, et al. “The Nonprofit Starvation Cycle (SSIR).” /Stanford Social Innovation Review: Informing and Inspiring Leaders of Social Change/, Stanford University, 2009, www.ssir.org/articles/entry/the_nonprofit_starvation_cycle

was the start of the philanthropic field investigating how underfunding public charities affects their sustainability and outcomes. Unrestricted support is a sign that a donor trusts an organization to use their own discretion to determine where funds are best utilized, and that support has been remaining steady at 20% of all philanthropic donations for over 30 years.⁴ Fifty-seven percent of donors believe that public charities spend too much on overhead, and that only 19% is a permissible amount.⁵ Trust is paramount to the success of a public charity, and unrestricted funds are a symptom of that trust.⁶ With no or very limited unrestricted funds, the staffing and retention, operating reserves and infrastructure of a public charity are diminished.

Staff are the core of every public charity; without competent, talented and motivated staff, no work would ever be accomplished. Due to a lack of unrestricted funding, public charities cannot competitively compensate their staff, and many have little to no retirement options, all of which leads to high turnover rates. These turnover rates are costly, not just in lost productivity, but in repeated recruitment and training costs for each new staff member. Private foundations are only as successful as their grants, which are only as successful as the organizations carrying out the work. However, those organizations are only as successful as the people who do the work.⁷ By not offering more unrestricted funding that would be able to cover staffing and benefits, private foundations are losing money on their own investments.

⁴ Paynter, “5 Ways Nonprofits Struggle.”

⁵ Joslyn, Heather. “‘Overhead’ Spending Has Little Impact on Giving, Study Suggests.” *The Chronicle of Philanthropy*. The Chronicle of Philanthropy, February 5, 2018. https://www.philanthropy.com/article/Overhead-Spending-Has/242434?cid=cpfd_home.

⁶ Bryce, Herrington J. “The Publics Trust in Nonprofit Organizations: The Role of Relationship Marketing and Management.” *California Management Review* 49, no. 4 (2007): 112–31. <https://doi.org/10.2307/41166408>.

⁷ Stahl, Rusty Morgen. “Talent Philanthropy: Investing in Nonprofit People to Advance Nonprofit Performance.” *The Foundation Review* 5, no. 3 (January 2013): 35–48.

Another key component to ending the nonprofit starvation cycle is to allow and encourage public charities to build up their operating reserves. As federal, state and local dollars are depleting, public charities face dire consequences without reserves. Most immediately, they can face cash-flow shortages if a grant is not renewed or a funder pays the grant with a substantial delay.⁸ Operating reserves allow organizations to have the flexibility to respond to new opportunities, innovate new programming and even consider investments to give them more financial security moving forward.

With an increase in operating reserves, public charities can turn their attention to strengthening infrastructure. Tim Delaney, President and CEO of the National Council on Nonprofits, defines infrastructure as, “capacity-building assistance: the intermediaries working at the local, state, regional, or national levels that offer management support, advocacy, training, technical assistance and other services to [foundation] grantees and...other nonprofits that benefit from them.”⁹ It allows these organizations to invest in hardware and software which increases staff productivity. Infrastructure improvements retain staff and can save time and money, thus adding to the overall operating reserves.

Historically, the industry-wide agreed-upon allowable indirect cost rate for a public charity has been 15%. This has begun to change in recent years – in 2016, the Ford Foundation announced they were doubling their allowable indirect cost rate from 10% to 20%.¹⁰ As already discussed, MacArthur will now be allowing up to 29% for indirect costs.

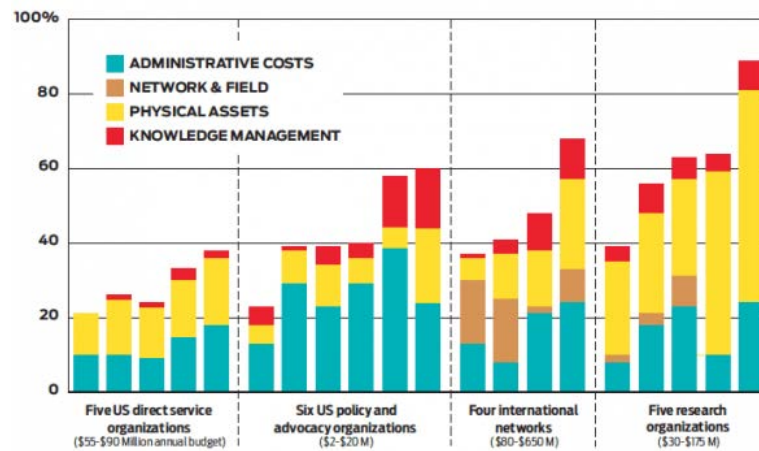
⁸ Moyers, Rick. “What Operating Reserves Are and Why They Matter.” The Chronicle of Philanthropy. The Chronicle of Philanthropy, April 29, 2011. <https://www.philanthropy.com/article/What-Operating-Reserves-Are/190577>.

⁹ Delaney, Tim. “Another Uncomfortable Conversation-Part II: The Risks of Underfunding Nonprofit Infrastructure.” Non Profit News | Nonprofit Quarterly, January 22, 2020. <https://nonprofitquarterly.org/another-uncomfortable-conversation-part-ii-the-risks-of-underfunding-nonprofit-infrastructure/>.

¹⁰ Walker, Darren. “Putting Ford Forward into Action.” Ford Foundation. Ford Foundation, June 30, 2016. <https://www.fordfoundation.org/ideas/equals-change-blog/posts/putting-ford-forward-into-action/>.

As outlined in *Figure 1*, indirect costs vary wildly depending on the work each organization is doing, and *Figure 2* highlights the gap in allowable indirect costs from major private foundations as of 2016. It is clear that there is no one-size-fits-all solution for allowable overhead, and that there is a clear gap between what public charities have been receiving and what they truly need.

*Figure 1: Actual Indirect Costs as a Percentage of Direct Costs*¹¹



¹¹ Eckhart-Queenan, Jeri, Michael Etzel, and Sridhar Prasad. “Pay-What-It-Takes Philanthropy.” *Stanford Social Innovation Review* 14, no. 3 (2016): 36–41.

Figure 2: Indirect Cost Policies of Major US Foundations ¹²

Indirect Cost Policies of Major US Foundations

Instead of paying for all of a nonprofit organization's indirect costs, most US foundations allow an organization to allocate only a small percentage of its grant to paying overhead—typically 15 percent—with the bulk of the grant having to go for direct program-related expenses.

Ford Foundation	20%
Bill & Melinda Gates Foundation	15%
Carnegie Corporation of New York	15%
John Templeton Foundation	15%
The California Endowment	15%
The John D. and Catherine T. MacArthur Foundation	15%
W. K. Kellogg Foundation	15%
Gordon and Betty Moore Foundation	12.5%
The Leona M. and Harry B. Helmsley Charitable Trust	10–20%
Lilly Endowment Inc.	10%
The Andrew W. Mellon Foundation	0%

Note: Data as of March 2016

These inconsistencies between what a public charity needs and what a funder is willing to support has given rise to creative bookkeeping and work-around grantmaking, which ultimately becomes burdensome and more costly to manage. ¹³ In order to continue to fund their preferred public charities, while also accounting for true indirect costs, private foundations ought to increase their payout from 5% to 8% per year to account for the additional costs.

The importance of increasing the private foundation payout rate is becoming more important each year as societal issues continue to worsen. The current 5% rate is limiting the nonprofit sector's ability to rapidly respond to increasing problems like inequitable distributions of wealth or climate change. The United States is currently one of the few countries in the world with a foundation payout minimum; Canada has a payout rate of 3.5% and the United Kingdom does not have a mandated payout rate. While our payout policies

¹² Eckhart-Queenan "Pay-What-It-Takes Philanthropy"

¹³ Ibid

are the most aggressive of the developed world, the average payout in the United Kingdom is, on average, higher than 5%.¹⁴ The United State has consistently been labeled the “most generous” country, giving more per capita than any other country in the world,¹⁵ and yet by limiting their payout rates, foundations are not giving nonprofit organizations the means to address short-term problems.

History/Background

In 1950, President Truman voiced concerns that business ventures could be presented under the guise of charitable activities to guarantee tax exemptions. As a result, that June the Ways and Means committee proposed legislation which have precluded staff, trustees, and other related parties from benefiting from the tax exemptions afforded to private foundations.¹⁶ Almost twenty years later, the Tax Reform Act of 1969 mandated that private foundations must payout a certain percentage of their assets relative to asset size. The legislation stated a preference for a distribution rate that was on par with yields from investments.¹⁷ In the Finance Committee, Senator Gore expressed a strong preference that foundations have a lifespan of no more than 25 years.¹⁸ In the Economic Recovery Tax Act of 1981 that was spearheaded by President Reagan, many laws were passed that would benefit the wealthy which included benefits for their charitable giving habits. This was when

¹⁴ Foundation Payouts. Accessed April 10, 2020. <https://www.alliancemagazine.org/analysis/alliance-audio-foundation-payouts/>.

¹⁵ Albrecht, Leslie. “The U.S. Is the No. 1 Most Generous Country in the World for the Last Decade.” MarketWatch. MarketWatch, December 7, 2019. <https://www.marketwatch.com/story/the-us-is-the-most-generous-country-but-americans-say-debt-is-keeping-them-from-giving-more-to-charity-2019-10-18>.

¹⁶ Troyer, Thomas A. “PDF.” Washington, 2000.

¹⁷ Treasury Department report on private foundations, Feb. 2, 1965, Treasury Department report on private foundations, Feb. 2, 1965 § (1965).

¹⁸ Troyer. “PDF.”

the payout rate was brought down from 6% to 5%.¹⁹ Legislators were weary of allowing such generous exemptions to people and had begun anticipating misuse of the law.

Legislators never intended for foundations to exist in perpetuity and never wanted private donors to benefit so heavily from tax incentives. Ultimately, Congress defended the charitable tax exemption because they viewed donors as relieving the burden of helping society from being solely the responsibility of the government.²⁰ However, as these foundations continued to pay out 5% of their assets, the income generated from their investment returns outpaced their charitable spending. The income generated from investment returns averaged closer to 12% than 5% from 1990-2000.²¹ The impact a foundation could have on the sector is limited by the decision to exist in perpetuity and distribute funds slowly.²² As seen in Figure 3: Payout and Total Return Across Foundations, the average return on a foundation's investments from 1972-1996 far exceeded the payout amount. A foundation's total return on investments continues to heavily outweigh the payout.

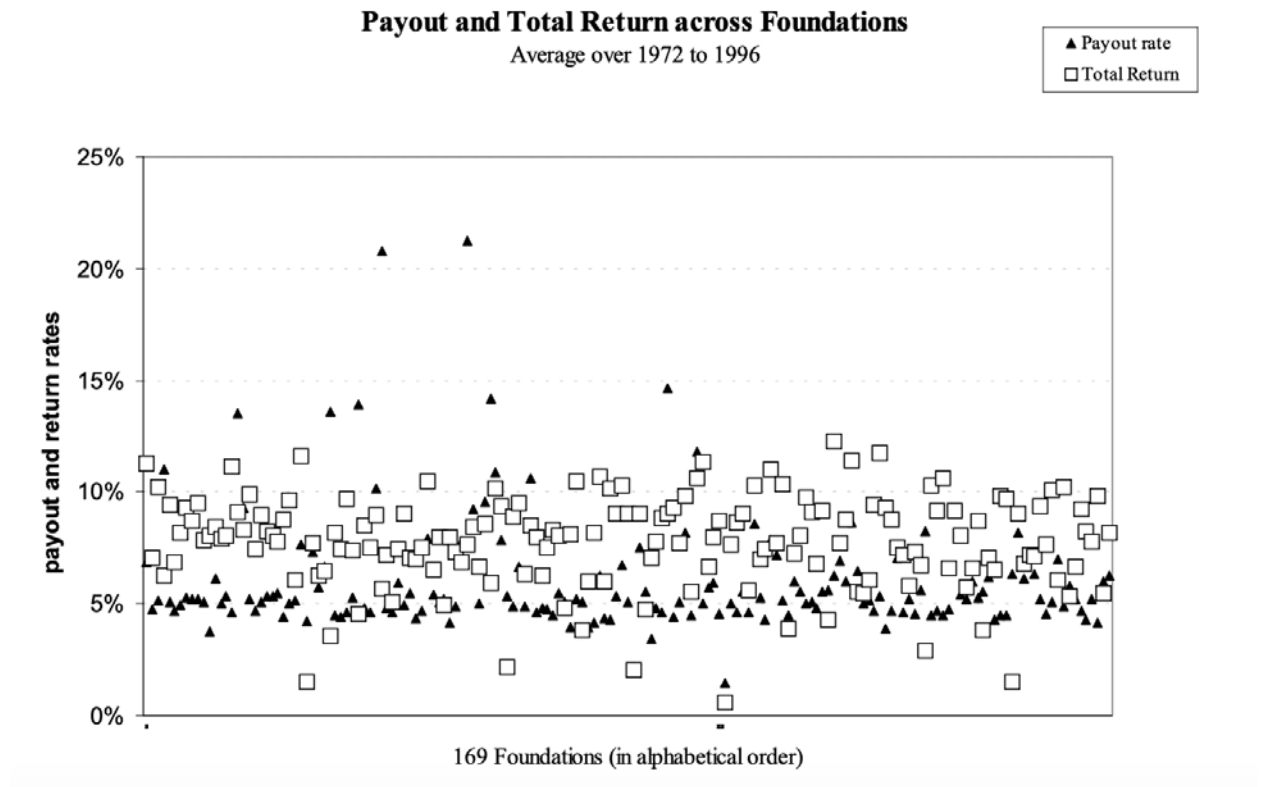
¹⁹ Clotfelter, Charles T. "Charitable Giving and Tax Legislation in the Reagan Era." *Law and Contemporary Problems* 48, no. 4 (1985). <https://doi.org/10.2307/1191488>.

²⁰ Kim, Angie, 2015.

²¹ Bradley, Bill, and Paul Jansen. "Faster Charity." *The New York Times*, May 15, 2002.

²² Ibid.

Figure 3: Payout and Total Return Across Foundations²³



Foundations continued to steadily grow their endowments until the Financial Crisis of 2008. As soon as the crisis hit, foundations expected to be able to give less in 2009 and 2010 than they did in 2008 as their endowments declined.²⁴ Foundations are one of the few consistent sources of discretionary capital funding available to public charities, which allows them to build up their financial reserves and become more financially resilient. A downturn in available funding from foundations led to a downturn in available reserves. Foundations

²³ Deep, A and Frumkin, P. (2001) /The Foundation Payout Puzzle/. The Hauser Center for Nonprofit Organizations, Kennedy School of Government Harvard University Working Paper No. 9. Available at https://cpl.hks.harvard.edu/files/cpl/files/workingpaper_9.pdf (Accessed March 10, 2020).

²⁴ Levine, Martin, Erin Rubin, Gene Takagi, Barbara Chow, Ruth E. Levine, Sean Buffington, and Ruth McCambridge. "Foundation Grantmaking during the 2008–2009 Economic Collapse." Non Profit News | Nonprofit Quarterly, August 9, 2014. <https://nonprofitquarterly.org/foundation-grantmaking-during-the-20082009-economic-collapse/>.

calculate their payouts using an average of 2-5 years of assets to account for exactly this type of potential economic downturn.²⁵ Due to steadily increasing endowments and the five-year averages surrounding for payout calculations, foundations are unlikely to go out of business because of a recession like the one in 2008 - the same cannot be said for the public charities they support.

Foundation endowments have continued to grow and recover since the 2008 Financial Crisis. They are still able to maintain their endowments at sustainable levels without consistent asset depletion.²⁶ The majority of foundations, over 71,000, exist in perpetuity, only paying out the minimum 5% of assets each year.²⁷ Those majority foundations that resist higher payout are essentially arguing for the ability to provide more charity in the future at the expense of current charity.²⁸ They also tend to grow more slowly and are managed more passively than the foundations which pay out more.²⁹ While foundations have recovered from the Financial Crisis, the organizations they support are still dealing with the aftermath and could benefit from more fiscal support from their funders.

There have been two main attempts at resolving this issue: foundations that sunset and foundations that increase their payout. Sunsetting a foundation is a term used for foundations that do not wish to exist in perpetuity. The primary cause for this is when there is a concern about the mission and values of a foundation shifting away from the donor's

²⁵ Ibid.

²⁶ Sansing, Richard, and Robert Yetman. "Governing Private Foundations Using the Tax Law." *Journal of Accounting and Economics* 41, no. 3 (2006): 363–84. <https://doi.org/10.1016/j.jacceco.2005.03.003>.

²⁷ Waleson, Heidi. "Beyond Five Percent." Northern California Grantmakers, May 29, 2014. <https://nccg.org/resources/beyond-five-percent>.

²⁸ Klausner, Michael D. "When Time Isn't Money: Foundation Payouts and the Time Value of Money." SSRN Electronic Journal, 2003. <https://doi.org/10.2139/ssrn.445982>.

²⁹ Sansing, Yetman. "Governing Private Foundations Using the Tax Law."

original intent.³⁰ A few foundations that have already sunset, or are planning to sunset, are the Whitaker Foundation, the Quixote Foundation and the Raikes Foundation. The Whitaker Foundation spent down their endowment of over \$800 million in 15 years. They saw the potential to address and solve a single and identifiable issue, in their case biomedical engineering, with a concentrated amount of funds.³¹ The Quixote Foundation announced in 2010 that it would sunset by 2017 stating, “The point is to become the most effective change agent we can be, even if that means not being a foundation anymore in the institutional sense.”³² The Raikes Foundation intends to spend down its funds by 2038 stating simply that they prefer to do as much as possible as soon as possible.³³ Even the Bill & Melinda Gates Foundation intends to sunset within 20 years following the death of its founders.³⁴

The other solution has been to pay out more than the legally mandated 5%. The San Francisco-based Goldman Fund raised their payout to 10% in 2007. The founder, Richard Goldman, felt the money should do work sooner rather than later, and was outspoken in his beliefs around heavy overhead rates at foundations and their steady accumulation of assets.³⁵ The Evelyn and Walter Haas, Jr. Fund pays out 5.5% in grants only, and does not include their administrative costs in their payout.³⁶ The Needmor Fund has a 6% minimum payout, but often grants more. Their investment policy states that, “[the] Spending Percentage as

³⁰ Smith, Fred. “For Sunsetting Foundations, a Limited Life but a Perpetual Contribution.” The Center for Effective Philanthropy, June 21, 2016. <https://cep.org/for-sunsetting-foundations-a-limited-life-but-a-perpetual-contribution/>.

³¹ Waleson. “Beyond Five Percent.”

³² Anderson, Keneta. “What's Up With Spending Everything While We Are Here?” Quixote Foundation, April 5, 2010. <http://quixotefoundation.org/exhibition/2010-04-05-whats-up-with-spending-everything.html>.

³³ “Why the Raikes Foundation Is Not a Perpetual Philanthropy.” Raikes Foundation, April 4, 2016. <https://raikesfoundation.org/blog/posts/why-raikes-foundation-not-perpetual-philanthropy>.

³⁴ “Foundation Trust.” The Bill & Melinda Gates Foundation. Accessed March 2, 2020. <https://www.gatesfoundation.org/Who-We-Are/General-Information/Financials/Foundation-Trust>.

³⁵ Waleson. “Beyond Five Percent.”

³⁶ Ibid.

approved by the Fund's board is six percent (6.0%). Given the current market assumptions, the 6% spending policy, and the anticipated annual contributions of approximately 3%, the Investment Committee believes that the assets will continue to grow at a sufficient rate to preserve purchasing power.”³⁷ These foundations with higher payouts are all organizations which wish to have the largest impact in the shortest amount of time.

Policy Proposal

The main objective of this proposed policy is to increase funding for public charities by increasing private foundation payouts to 8% by 2025. The goal of the Foundation Payout Increase policy is to maximize the number of philanthropic dollars given to the nonprofit sector each year, allowing public charities who depend on private foundation dollars more funding for their programming. This policy recommends updating the Internal Revenue Code Section 4942. IRC section 4942 defines a private foundation's qualifying distributions and set the legal minimum at 5% over a three-year average. This policy recommends the legal minimum for qualifying distributions be increased to 8% over that same three-year average.³⁸ The current payout rate of 5% is helpful to private foundations during periods of economic tumult such as the 2008 Financial Crisis, but an increased payout rate would allow private foundations to do preventative giving to stop societal issues from worsening.³⁹ This policy would be implemented over five years by the Internal Revenue Service, giving private foundations time to reassess their grantmaking strategies before being subjected to the 8% payout. By addressing the disparity between private foundation endowments and the

³⁷ “Needmor Fund Investment Policy.” Toledo, OH, September 2004.

³⁸ United States, Congress, “Qualifying Distributions.” Qualifying Distributions, 4942nd ed., IRC, 1969.

³⁹ Deep, A and Frumpkin, P. (2001) /The Foundation Payout Puzzle/. The Hauser Center for Nonprofit Organizations, Kennedy School of Government Harvard University Working Paper No. 9. Available at https://cpl.hks.harvard.edu/files/cpl/files/workingpaper_9.pdf (Accessed March 10, 2020).

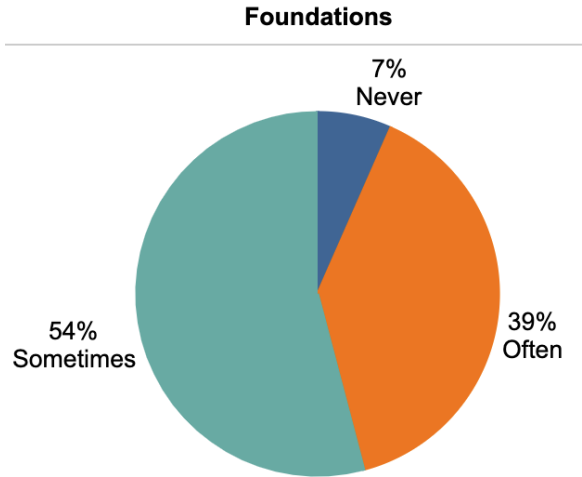
organization budgets of the public charities they support, the Foundation Payout Increase achieves its goal of maximizing the number of philanthropic dollars in the nonprofit sector.

Policy Analysis

In weighing the advantages and disadvantages of the Foundation Payout Increase, it is important to assess the policy components and outcomes. One must determine if a foundation increasing its endowment payout and injecting those dollars into public charities is worth the cost of decreasing foundation assets they could put into public charities at later dates. The rising new forms of philanthropy that have been emerging, such as Donor-Advised Funds and LLCs also play a pivotal role in determining the relevance of the philanthropic payout rate. Ultimately, the policy must be deemed effective, efficient and equitable for honest consideration. Without a fair assessment of the policy, it cannot be determined as harmful or beneficial.

If private foundations were to increase their payout rate from 5% to 8%, they would infuse not only money into the nonprofit sector, but through those funds they would also inject efficiency and innovation. By covering the true costs of nonprofit programming, with allowable overhead rates of at least 29%, private foundations would be able to decrease the costly turnover in the nonprofit sector, allow for the creation and growth of operating reserves, and strengthen nonprofit infrastructure. Nonprofits have historically felt underfunded by the foundations that support them. In the 2018 Nonprofit Finance Fund State of the Nonprofit Sector Survey, findings seen in *Figure 4* show that 93% of organizations surveyed felt underfunded by foundations either “sometimes” or “often.” More financial support, particularly in unrestricted funding, would allow nonprofits to feel secure enough to take more innovative risks programmatically.

Figure 4: Do Nonprofits Feel Underfunded by Foundations? ⁴⁰



However, one must also consider the negative ramifications of increasing the private foundation payout to 8%. While the average foundation endowment grew by 12% from 1990-2000, that figure does not capture the state of endowments after the 2008 financial crisis, when they dropped by 26%.⁴¹ Foundation returns have dropped as recently as 2018. After years of economic growth, foundations reported an average return of -3.5% in 2018, the lowest since the 2008 crisis.⁴² A payout rate of 8% would force private foundations to spend from their endowments at a time when they are the most vulnerable and would affect their giving potential for future years.

A private foundation payout increase also does not take into account the new forms of philanthropic giving that have been on the rise: LLCs and Donor Advised Funds. In recent years, LLCs have become more popular with organizations such as the Emerson Collection and the Chan Zuckerberg Initiative paving the way for smaller organizations.

⁴⁰ “State of the Nonprofit Sector Survey.” Nonprofit Finance Fund, May 9, 2018. <https://nff.org/learn/survey>.

⁴¹ Caroline Preston, “Foundation Endowments Dropped by 26% in 2008,” The Chronicle of Philanthropy (The Chronicle of Philanthropy, July 2, 2009), <https://www.philanthropy.com/article/Foundation-Endowments-Dropped/174703>

⁴² Candid, “Foundation Investment Returns Fell Significantly in 2018, Study Finds,” Philanthropy News Digest (PND), August 19, 2019, <https://philanthropynewsdigest.org/news/foundation-investment-returns-fell-significantly-in-2018-study-finds>

LLCs are a pass-through entity for tax purposes which, when used philanthropically, have no need for minimum distributions, have no limitations on lobbying, and no public tax filings of a 990 with revenue, expenses, and top salaries.⁴³ Donor Advised Funds have also been growing rapidly in recent years, growing four times faster than individual giving as a whole in 2016.⁴⁴

Donor Advised Funds, as the name suggests, acts as a brokerage service for donors who wish to make charitable donations but do not wish to establish a private foundation, something that can be costly to achieve. Charitable contributions are tax-deductible as soon as they are given to the Donor-Advised Fund, are exempt from the capital gains tax, and the contributions do not need to be made in any specific period of time. They are particularly popular in areas such as Silicon Valley where individuals who work in the growing tech sector have seen their stock values skyrocket, with the accompanying capital gains tax.⁴⁵ Donor Advised Funds are a way for those individuals to receive a tax write-off while avoiding capital gains, while the money is collecting interest in the fund, with no deadline for donations. As more individuals are starting to use new forms of philanthropic giving like Donor Advised Funds and LLCs that have their own legal loopholes, it in turn makes the 5% payout of private foundations seem more than sufficient, if not a little extravagant comparatively.

Increasing the private foundation payout rate would be effective in increasing the efficiency of the nonprofit sector. By comparing progressive and conservative youth

⁴³ Ellis Carter, "LLCs as Philanthropic Vehicles," Charity Lawyer Blog, April 6, 2018, <https://charitylawyerblog.com/2015/12/15/llcs-as-philanthropic-vehicles/>

⁴⁴ Richard Eisenberg, "There's A Target On Charity's Booming Donor-Advised Funds," Forbes (Forbes Magazine, August 2, 2018), <https://www.forbes.com/sites/nextavenue/2018/08/02/theres-a-target-on-charitys-booming-donor-advised-funds/#aabbacb7a327>

⁴⁵ Ibid.

organizations and their funding streams, we can see this increase in efficiency in action. Progressive youth organizations received \$37,936,088 in revenue in 2014, while their conservative counterparts received a total of \$105,431,611. As a result, conservative youth organizations have been able to invest more in their staff, reserves, and make investments in land and properties than progressive youth organizations, leading to more programmatic success and public awareness. They not only have more revenue, but conservative youth organizations also outspend progressive ones.⁴⁶ “Historically, the [conservative] movement has centered its funding priorities around long-term strategies.”⁴⁷ If philanthropy could fund the nonprofit sector the way the conservative movement has funded youth organizations, focusing on long-term strategies and long-term fiscal health, they could see similar successes. The model of investing more in organizations to build their reserves, decrease turnover and increase efficiency has been proven in specific fields and would be replicable throughout the sector.

There are great costs associated with the tax benefits of private foundations. “When an individual contributes \$100 to a charity, the nation loses about \$40 in tax revenue, but the charity gets \$100, which it uses to provide services to society. The immediate social benefit, then, is 250% of the lost tax revenue. When \$100 is contributed to a foundation, the nation loses the same \$40. But the immediate social benefit is only the \$5.50 per year that the foundation gives away—that is, less than 14% of the forgone tax revenue.”⁴⁸ The social benefit using the 5% payout method is clearly both truncated and delayed. There is a high

⁴⁶ Hannah Finnie et al., “Building Tomorrow: The Need for Sustained Investment in America's Progressive Youth,” Issuu (Young People For, April 2017), https://issuu.com/youngpeoplefor/docs/youth_infrastructure_paper_final

⁴⁷ Ibid.

⁴⁸ Porter, Michael E., and Mark R. Kramer. “Philanthropy’s New Agenda: Creating Value.” *Harvard Business Review*, 1999.

administrative burden associated with running a private foundation and the administrative costs for public charities to apply are high as well. By increasing payouts, there is an immediate and tangible social benefit.

Changing the tax code can be a costly undertaking. For instance, the Tax Cuts and Jobs Act of 2017 was estimated to cost approximately \$397 million to implement.⁴⁹ The Foundation Payout Increase policy would take nominal resources to implement, as the baseline policies are already in place for a foundation payout as listed in the IRC section 4942. An increase to 8% from the existing 5% payout rate would be noted as an amendment to IRC section 4942 and would need to be communicated to organizations such as the Financial Accounting Standards Board (FASB) to ensure enforcement of the new payout rate by auditors. The only necessary external changes would be regarding communication and enforcement, which would cost a minimal amount comparatively to a major overhaul of the tax code such as the Tax Cuts and Jobs Act, and the benefits would be an influx of dollars into the nonprofit sector to encourage growth and innovation.

The question of equity is a common one in the philanthropic sector. Four years after its 1992 founding, the H.B. Heron Foundation began considering what could be done with the 95% of its endowment that was not explicitly stated for charitable purposes each year. Their board determined that, “the foundation should be more than a private investment company that uses its excess cash flow for charitable purposes.”⁵⁰ Within ten years, their mission-related activity comprised 40 percent of its overall endowment.⁵¹ Foundations who justify their desire to exist in perpetuity by the current 5% payout rate are ignoring that many

⁴⁹ Tax Cuts and Jobs Act: Assessment of Implementation Efforts, Tax Cuts and Jobs Act: Assessment of Implementation Efforts § (2019).

⁵⁰ FB Heron Foundation. “The Evolution of Heron: Heron Foundation.” FB Heron Foundation, December 5, 2017. <https://www.heron.org/enterprise>.

⁵¹ Ibid.

of the crises they are trying to resolve are getting worse each year. The funds of a private foundation that supports climate change are less useful after 2030 when the effects of climate change are irreversible.⁵² Much like with investments in general, private foundations who invest more dollars into their programming now are more likely to see greater returns on those investments in terms of programmatic delivery and organizational health. The word “philanthropy” comes from the Greek for “love of mankind,” and private foundations who wish to embody that definition should desire to financially support the causes they support to the best extent possible. Foundations have the privilege and power of determining where resources will have the largest impact, and how large those resources ought to be. Few foundations consider how they can strategically create the most value for society with their investments.

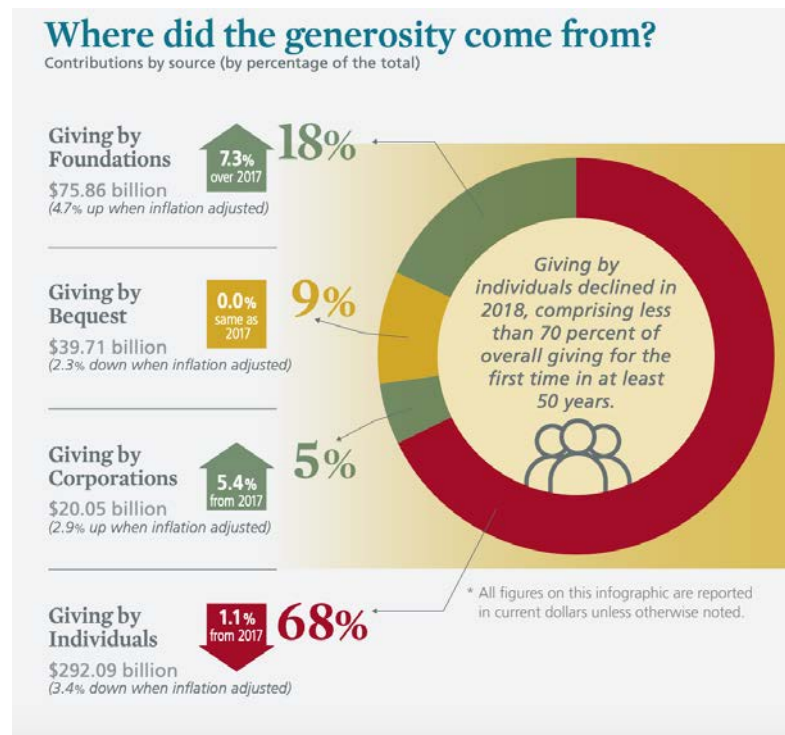
Political Analysis

There is clearly a desire for generosity in the United States. Even in 2017 when the number of individuals who had donated dropped from 2016, the total dollar amount of money given went up by \$20 billion, or 3%, from 2016.⁵³ As seen in *Figure 5*, of the \$427.71 billion contributions contributed to the nonprofit sector in 2018, only 18% of that was from foundations. If more Americans want to see our continued giving to charitable causes, they will be inclined to support legislation that will increase that percentage.

⁵² “Only 11 Years Left to Prevent Irreversible Damage from Climate Change, Speakers Warn during General Assembly High-Level Meeting | Meetings Coverage and Press Releases.” United Nations. United Nations, March 28, 2019. <https://www.un.org/press/en/2019/ga12131.doc.htm>.

⁵³ Osili, Una, and Sasha Zarins. “Fewer Americans Are Giving Money to Charity but Total Donations Are at Record Levels Anyway.” The Conversation, March 6, 2020. <https://theconversation.com/fewer-americans-are-giving-money-to-charity-but-total-donations-are-at-record-levels-anyway-98291>.

Figure 5: 2018 Contributions by Source of Contributions⁵⁴



There have been recent successful changes to legislation surrounding philanthropy such as H.R. 1865 or the “Further Consolidated Appropriations Act, 2020” passed in December 2019. In it, the excise tax was reduced to a flat 1.39% instead of the circumstantial 1%-2% it had been prior, allowing foundations to focus on grantmaking without a lens of tax considerations. The unrelated business income tax (UBIT) on qualified transportation fringe benefits was also removed.⁵⁵ Both of those changes happened quickly and quietly, and the Foundation Payout Increase policy would likely follow their path of implementation for the general public.

In order for the Foundation Payout Increase policy to successfully occur, it will need to be approved with a majority in the House and Senate. With the current Democratic-

⁵⁴ *Giving USA 2019: The Annual Report on Philanthropy for the Year 2018*, a publication of Giving USA Foundation, 2019, researched and written by the Indiana University Lilly Family School of Philanthropy.

⁵⁵ Berman, Henry. “New Legislation Impacting Private Foundations.” Exponent Philanthropy, January 6, 2020. <https://www.exponentphilanthropy.org/blog/new-legislation-impacting-private-foundations/>.

controlled House, this bill is likely to pass as House Democrats are more likely to be supportive of social services and charitable causes than their Republican counterparts. For example, they passed S.Res. 540: “A resolution recognizing the contributions of AmeriCorps members and alumni to the lives of the people of the United States”⁵⁶ to thank past AmeriCorps volunteers and help with recruitment for future years in February of 2019. They also passed H.R. 430, TANF Extension of 2019, into law in January 2019 to extend the Temporary Assistance to Needy Families program grants into Puerto Rico and the territories of the United States.⁵⁷ There is less evidence that the Republican controlled Senate would be as amenable to legislation that resembles a tax increase for private foundations. The last time major changes were made to the tax code that affected the foundation payout rate was the Economic Recovery Tax Act of 1981, where the payout rate was reduced from 6% to the current 5%. In another Republican majority Senate, we should expect a similar preference for lowering the payout rate rather than increasing it.

However, there is evidence of Americans desiring that philanthropy solve social problems. In a 2015 poll conducted by The Philanthropy Roundtable, 47% of respondents indicated that they prefer philanthropic aid solves social problems instead of the government, 59% of those same respondents believed that private charities are more cost-effective at promoting social good than the government, and 86% felt that it is important for Americans to give time and money to charities.⁵⁸ These Americans could be persuaded to support a Republican candidate who supported legislation to increase the foundation payout

⁵⁶ U.S. Congress, House, A resolution recognizing the contributions of AmeriCorps members and alumni to the lives of the people of the United States., S.Res.540, 116th Cong., 2nd sess., introduced in House March 11, 2020, <https://www.congress.gov/bill/116th-congress/senate-resolution/540/text>.

⁵⁷ U.S. Congress, House, TANF Extension Act of 2019, H.R. 430, 116th Cong., 2nd sess., introduced in House January 10, 2019 <https://www.congress.gov/bill/116th-congress/house-bill/430/text?r=5&s=6>,

⁵⁸ “National Poll.” Philanthropy Roundtable. Philanthropy Roundtable. Accessed April 12, 2020. <https://www.philanthropyroundtable.org/almanac/statistics/national-poll>.

rate if it were framed as a cost-savings measure for the government, and would be a way to keep from increasing taxes for the individual constituent.

Republicans would support this policy to increase American giving to social problems such as homelessness, climate change, criminal justice and more, without having to increase taxes and have the government be solely responsible for resolving them. In a 2019 CNBC survey, there was majority support regardless of political party for government support of progressive policies such as paid maternity leave, government funding for childcare and boosting the minimum wage. There are some progressive policies that are universally appealing regardless of political parties, particularly those which benefit constituents making less than \$75,000 annually.⁵⁹ Republican lawmakers may receive pushback from their wealthier constituents who would benefit from the tax benefits of a private foundation, but as we approach elections this November Republicans must be cognizant of appealing to the majority of constituents to ensure their votes, not just the wealthy ones.

Democrats will support this policy because it will increase the funds going to support issues their constituents care deeply about. National foundations have been heavily investing in reducing poverty and growing economic growth, and community-driven solutions for economic success.⁶⁰ A January 2020 Gallup poll listed climate change, education, LGBTQ rights, race relations and wealth distribution as top issues for Democratic voters as they head to the polls in November.⁶¹ If Democratic Senate members can prove that increasing the

⁵⁹ Liesman, Steve. "Majority of Americans Support Progressive Policies Such as Higher Minimum Wage, Free College." CNBC. CNBC, March 27, 2019. <https://www.cnbc.com/2019/03/27/majority-of-americans-support-progressive-policies-such-as-paid-maternity-leave-free-college.html>.

⁶⁰ *Giving USA 2019: The Annual Report on Philanthropy for the Year 2018*.

⁶¹ Hrynowski, Zach. "Several Issues Tie as Most Important in 2020 Election." Gallup.com. Gallup, January 13, 2020. <https://news.gallup.com/poll/276932/several-issues-tie-important-2020-election.aspx>.

foundation payout rate will increase funding to the core issues their constituents prioritize then they are well-placed for reelection in the fall.

This policy proposal requires a very small administrative lift, a low cost to execute, and has the potential to gain constituent support for representatives in a pivotal election year. Overall, the program is designed to increase the dollars spent on solving our societal issues by increasing the mandatory foundation payout rate by less than the returns foundations are seeing on their endowments.

Recommendation

There are those who argue that if private foundations cannot exist in perpetuity, then there will be irreversible damage done to the nonprofit sector. “Perpetual foundations [are] the mainstays of many charities, providing steady support year after year for local community needs including homeless shelters, arts programs, conservation efforts, youth sports programs, and other important pillars of civil society.”⁶² Spending more of philanthropic endowments now means there will be less funding available to the nonprofit sector in the future. Long-term philanthropy has been beneficial to social causes such as the civil rights movement, and ongoing endowments create a sustainable source of funding throughout economic recessions.⁶³

However, there are past circumstances that illustrate funding causes in perpetuity can be shortsighted. Orphanages were once recipients of a large portion of philanthropic funds, and now they are mostly closed in Europe and North America in favor of other models such

⁶² Parnell, Sean. “Higher Foundation Payout Requirement Would Be A Mistake.” *Philanthropy Daily*, June 27, 2019. <https://www.philanthropydaily.com/higher-foundation-payout-requirement-would-be-a-mistake/>.

⁶³ Murray, Sarah. “From Here to Eternity: Philanthropy the Perpetual Foundation.” *The Financial Times*. December 1, 2017. <https://search-proquest-com.proxy1.library.jhu.edu/docview/1970411871/9A78005E97214ADBPO/1?accountid=11752>.

as adoption and the foster care system.⁶⁴ Other causes are in need of funding now that, if too much more time is spent waiting for a solution, will be beyond repair. This can be seen in the case of climate change - the damage done to the planet will soon be irreversible, making additional spending on it in another three decades seem impossible and unnecessary.⁶⁵ The same could be said of small nonprofits working to help their communities in the midst of an economic crisis. If a time of crisis is not the time to increase support, then that organization may not exist beyond the crisis to help that community.

I am recommending that you approve this proposal. Increasing the private foundation payout has no negative ramifications on the average American citizen. More funds will be available to the organizations working within their communities at no expense to them, and more dollars will be injected into the economy via the nonprofit sector. Private foundations enjoy the benefit of a tax-exempt filing status with the IRS, while also enjoying the benefit of an invested endowment. A payout rate of 8% leaves foundations with healthy endowment sizes to invest when the economy is doing well, and sufficient funds available to help the organizations and causes they support when the funds are needed most. Vu Le, author of the popular nonprofit blog Nonprofit AF, wrote in an August 2019 post after an increase in mass shootings in the United States, “the hoarding of 95% of the resources has starved nonprofits’ abilities to do our work, which has allowed injustice to go on unchecked and has led to the death and suffering of thousands. This makes it unethical.” The time to increase foundation payouts is now, after years of small grants from foundations with large endowments, when organizations and the people they serve need support the most.

⁶⁴ Ibid.

⁶⁵ Kramer, Larry. “Philanthropy Must Stop Fiddling While the World Burns (Opinion).” *The Chronicle of Philanthropy*. The Chronicle of Philanthropy, January 7, 2020. <https://www.philanthropy.com/article/Philanthropy-Must-Stop/247761>.

MARIA-VERONICA BANKS

EDUCATION

Johns Hopkins University, Krieger School of Arts and Science

2018-2020

Masters of Arts; Public Management

- Advanced Academic Programs, Department of Governmental Studies
- Capstone: “Foundation Payout Increase” policy proposal and analysis to address the low private foundation payout rate in the United States.
- Capstone Advisor: Professor Paul Weinstein

Courses: Fundamentals of Quantitative Methods; Public Policy Evaluation & The Policy Process; Financial Management and Analysis; Fundamentals of Nonprofits and Nonprofit Management; Financial Management and Analysis in Nonprofits; Negotiating as a Leadership Skill; Global Political Economy; Economics for Public Decision-Making; Database Management Systems; Organizational Leadership and Ethics in NGO Management; Institutional Fundraising; Nonprofit Governance and Executive Leadership.

Christopher Newport University

2006 - 2010

Bachelors of Arts; Political Science Minor: English Literature

WORK EXPERIENCE

Consultant

2020-Present

Fiscal Management Associates (FMA)

- Research and draft reports and actionable recommendations
- Researches and develops content for products and services
- Supports planning and implementation of financial systems and practices
- Develops curriculum and facilitates workshops in training initiatives
- Conducts grantee financial due diligence
- Design new business processes, provide guidance and analytical support with respect to financial trends analysis and planning.

Grants Manager

2014 – 2018

Public Welfare Foundation

- Managed the entire grant administrative process from the initial application to the closing of the grant, ensuring compliance with legal requirements, accounting standards and Foundation requirements for all grants, awarding \$20M of grants annually
- Prepared monthly and year-end financial and grant approval reports for program and cash flow/budget planning purposes
- Developed and provided training on all aspects of grantmaking and IT policies and procedures within the organization
- Managed the Foundation’s relationship with its IT vendor, including annual budget planning and supervision of project implementation for IT capital projects regarding software/hardware modifications and audio/visual needs.

- Initiated and executed the RFP process to select and launch a new cloud-based grants management database solution
- Facilitated transfer of all organization data from onsite servers into a hosted environment with the Foundation's IT vendor
- Created an implementation plan to new computers, printers and monitors for all staff and ensured the successful move to Office 365 in collaboration with the Foundation's IT vendor
- Led an internal team to improve the Foundation's grantmaking during the strategic planning process

Grants and Contracts Coordinator

2013 - 2014

International Youth Foundation

- Coordinated all aspects of grantmaking and contracting activities, including processing legal
- agreements and facilitation of payments to over 180 organizations and over 200 consultants
- Performed legal and government due diligence, and finalized fiduciary due diligence, to ensure legal compliance and financial capacity of each prospective grantee
- Compiled analytic information and statistics on IYF's grantmaking activities

Business Development Coordinator

2011 - 2013

International Youth Foundation

- Managed Raiser's Edge donor database, including inputting contacts and running queries as needed for publication and solicitation mailings
- Supported the development of public and private sector proposals, including the recruitment process for outgoing proposals

AmeriCorps*VISTA – Fund Development Specialist

2010-2011

The Advancement Foundation

- Generated documentation of upcoming private foundation grant deadlines along with tracking proposal statuses
- Created and managed a team for grant identification and proposal writing
- Solicited over \$300,000 and won over \$122,500 in funding for nonprofits in the Roanoke Valley

VOLUNTEER EXPERIENCE

Grant Writer

2013 – 2014

FORCE – Upsetting Rape Culture

- Researched funders and wrote grant proposals for a Monument Quilt to serve as a safe space for rape and abuse survivors to share their stories

Connections Committee Member

2014-2018

PEAK Grantmaking

- Organized social and networking events for philanthropic professionals at the Annual PEAK Grantmaking Conference each March